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RUEHMO/AMEMBASSY MOSCOW 1630
RUEHLO/AMEMBASSY LONDON 0068
RUEHML/AMEMBASSY MANILA 1269
RUEHOT/AMEMBASSY OTTAWA 0360
RUEHSH/AMCONSUL SHENYANG 0231
RUCPODC/USDOC WASHDC 1131
RUEATRS/DEPT OF TREASURY WASHDC
RUEHRC/DEPT OF AGRICULTURE WASHDC
RUEHLMC/MILLENNIUM CHALLENGE CORP WASHINGTON DC 0405
RUEKJCS/SECDEF WASHDC
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UNCLAS SECTION 01 OF 03 ULAANBAATAR 000847

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SUBJECT: Mongolia's Savings and Loan Crisis Contained?

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11. (SBU) SUMMARY: Last spring, 27 of Mongolia's largest Savings and Loans (S&L) cooperatives (among 900) collapsed in rapid succession under the weight of bad loans, abysmal management practices and swirling rumors of corruption. Quadrupling in size over the past two years Mongolia's dodgy S&L industry flourished because of an inadequate legal system and a legacy of lax supervision by banking authorities. High deposit interest rates supported by extremely high lending rates enticed many Mongolians to entrust their life savings to the cooperatives. The industry grew too big too fast, according to local analysts; and, flush with funds, the largest overextended themselves with risky loans and bad investments. Some are also suspected of dabbling in corruption and cronyism, pilfering deposits for personal use or interest free loans to friends. When the end finally came, over 10,000 mostly middle class depositors had reportedly lost a total of US\$55.6 million, or approximately US\$5,000 per depositor. To date, there have been modest protests by depositors and countless, and improbable calls for the Government of Mongolia to make good on their losses. END SUMMARY.

It's the Government's Fault

12. (SBU) Although investigation results are still pending, many Mongolians have apparently convinced themselves that Mongolia's politicians used the S&L coops as their personal piggybanks and profited from the misfortune of others. Public perception of their complicity in the S&L collapse is quickly becoming a political reality.

13. (SBU) To drive the point home, several female victims of the failed S&Ls began staging a public hunger strike recently in Ulaanbaatar's Sukhtbaatar Square. They demand that the GOM, especially Parliament and the Bank of Mongolia, be held accountable for the bankruptcy of all savings and credit unions; and that the GOM immediately reimburse all victims for the full value of their lost savings. They accuse both Parliament of negligence for allowing

S&Ls to grow under weak legislation and particularly the Central Bank for failing to properly monitor and supervise S&L financial dealings.

14. (SBU) Smelling blood, the minority Democratic Party recently tried to hold up a parliamentary vote on a new Central Bank Governor, demanding first that the outgoing governor's tenure undergo a thorough review, particularly his actions, or lack thereof, surrounding the S&L collapse. Ruling MPRP leaders managed to stop it, but came out looking like a party with something to hide.

The President "Feels Their Pain"

15. (SBU) In what appeared to be an impromptu statement, President Enkhbayar remarked in his speech at the opening of parliament in early October that S&L victims should be compensated for money lost through no fault of their own. The President's comments blindsided many in the GOM, who have since quietly insisted that the President's wishes in this case in no way represented official GOM policy. Facing budget constraints, budget planners have branded as unworkable any plan to financially reimburse victims as budget outlays have already increased for social welfare expenditures; and there is the expectation of revenue shortfalls due to new tax cuts. Politicians are also feeling pushback from their constituents who object to using public tax monies to compensate depositors.

16. (SBU) Despite this, President Enkhbayar continues to argue for helping victims, but he now says that reimbursements should come in the form of various financial support projects, such as free scholarships to affected students to complete their post-graduate degrees; opportunities for land ownership; ownership of shares in

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certain state-run enterprises; helping victims migrate to foreign countries to work there; and long-term home mortgage loans. He has urged parliament to include such programs in the current budget debate. (NOTE: A disgruntled group of S&L depositors sent a letter to the Ambassador seeking "asylum" in the U.S. from the GOM, which they argued "failed to protect them" and their livelihoods. Post's response noted there are no such provisions in U.S. immigration laws.)

17. (SBU) Many suggest that the President is simply employing the well worn tactic of appearing to address protestors concerns while intending to do little or nothing after they abandon the streets, and hoping the demands will slowly recede from memory.

FRC Crackdown Draws Blood-Unfortunately Its Own

18. (SBU) Prosecutors continue to investigate; but could not say if or when charges might be brought, which has only fanned public suspicions of a cover up. Meanwhile, Mongolia's independent Financial Regulatory Commission (FRC), just created in January this year, is making up lost ground by working to shut down failing cooperatives, forcing all coops to seek new operating licenses to weed out those that are failing or corrupt, trying to detect hidden assets and force cooperatives to repay deposits that have been misused. Regulators are drawing legislation setting out rules for the savings and credit cooperatives that Parliament will discuss in the fall session. The law would close many of the loopholes that allowed fund managers to misuse investor monies. Currently, regulation of S&Ls falls under a more general law from 1998 regulating all kinds of cooperatives. Regulators told Econoff that they have based their draft on a model provided by the World Council of Credit Unions.

19. (SBU) FRC actions have drawn strong, even violent reaction. In June, the FRC's first Chairman, D. Badraa was stabbed to death outside his office six months after being appointed, murdered by the director of construction firm involved in one of the coops he had been investigating.

S&Ls-We Still Love You

¶10. (SBU) FRC members argue that the S&L cooperatives that failed were exceptions rather than the rule, and that overall the industry is relatively healthy filling an important place in the country's financial sector. Only 27 of the over 900 coops in Mongolia failed (albeit the largest ones), and regulators believe that many of the remaining coops are more or less properly managed. D. Bayarsaikhan, Badraa's replacement as Chairman of the FRC, believes that S&L coops' short term, low rate loans, provide a valuable source of microcredit in Mongolia. Even so, of the 300 or so of the coops that have reapplied for licenses, as required under new regulations, only 26 have been approved. Bank of Mongolia officials have assured Emboffs that there is no risk of a "run on the S&Ls" that might undermine Mongolia's financial system.

COMMENT: The Silver Lining?

¶11. (SBU) The big winner in the S&L crisis may be Mongolia's formal banking sector. As investors reconsider the inherent risks of investing in badly managed and opaque S&Ls, more and more Mongolians appear to be choosing to entrust savings in the better-known, respected banks that have been operating under a much tougher regulatory regime. Mongolia's largest bank Khan Bank, for example, has reported a 35% increase in savings deposits over the first six months of this year, much of that credited to fallout from the S&L collapse. A recent poll found that Khan Bank was the number one trusted bank in Mongolia, effectively allowing them to pay 2% less interest to depositors over competitors. Other major banks have

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reported similar increases in deposits. So maybe this time the "good guys" (or at least the "better guys") will win. On the political side, the demand by S&L depositors that the GOM make them whole has recent precedents. A fire earlier this year at a local market left several hundred small vendors and merchants destitute. A small group staged a protest in the central square demanding the GOM compensate them for losses. The GOM reportedly "leaned" on the market's owner to liquidate their company's holdings to compensate the "victims." END COMMENT.

MINTON